

**STATE OF RHODE ISLAND AND  
PROVIDENCE PLANTATIONS**

**BEFORE THE PUBLIC UTILITIES COMMISSION**

**Re:   THE APPROPRIATE FORM OF REGULATION            )       DOCKET No. 3495**  
**FOR ISLAND HI-SPEED FERRY LLC                    )**

**DIRECT TESTIMONY**

**OF**

**JOHN STUTZ**

**On behalf of:**

**The Rhode Island Division of Public Utilities and Carriers**

**June 23, 2003**

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Exhibit JS-1 Dr. Stutz’s Testimony Before Regulatory Commissions

## 1. INTRODUCTION

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.**

A. My name is John K. Stutz. My business address is the Tellus Institute (Tellus), 11 Arlington Street, Boston, Massachusetts 02116-3411. I am a vice president at Tellus where I have been employed since 1976.

**Q. PLEASE DESCRIBE TELLUS.**

A. Tellus is a non-profit organization. It provides research and consulting services to clients in the public and private sectors in the areas of energy and environmental policy, solid waste management, sustainable development and water resource planning.

**Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK HISTORY.**

A. I received a B.S. from the State University of New York at Stonybrook and a Ph.D. from Princeton University. Both degrees are in mathematics. After completing my Ph.D., I taught and did research at the Massachusetts Institute of Technology, the State University of New York at Albany where I received tenure, and Fordham University where I held the position of associate professor of mathematics and was co-director of the program in mathematics and economics. I left Fordham to help found Tellus.

**Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

A. I have extensive experience in the utility industry, particularly as an expert witness. Since 1977 I have appeared before the Federal Energy Regulatory Commission (FERC) as well as Public Utility Commissions in 39 states, the District of Columbia, and three provinces in Canada. In total, I have appeared in 172 proceedings as shown in Exhibit JS-1. Most of

1 my appearances have been in electric utility proceedings. However, I have also testified  
2 on gas and telecommunications matters.

3 In addition to my utility-related activities, since 1988 I have worked regularly for  
4 the United States Environmental Protection Agency (EPA), the Organisation for  
5 Economic Cooperation and Development (OECD), and various state and local agencies.  
6 This work has focused on solid waste management and its impact on the environment.

7 **Q. DOES YOUR UTILITY-RELATED EXPERIENCE INCLUDE RATEMAKING?**

8 A. Yes. My first appearance as an expert witness on ratemaking was in 1979. Since then, I  
9 have appeared as a witness on ratemaking in 114 proceedings, as shown in Exhibit JS-1.  
10 My testimony has addressed a variety of topics, including marginal costs, embedded cost-  
11 of-service studies, service quality standards, and many aspects of rate design. My articles  
12 and comments on utility ratemaking have appeared in the *Public Utilities Fortnightly*,  
13 *The Electricity Journal*, and elsewhere. My paper with Thomas Austin is cited, in the  
14 second edition of Bonbright's *Principles of Public Utility Rates*, as a source of  
15 information on electric ratemaking in general and COSS in particular. I was the lead  
16 author of *Aligning Rate Design Policies with Integrated Resource Planning*, a white  
17 paper commissioned by National Association of Regulatory Utility Commissioners  
18 (NARUC). As NARUC's preface states, Tellus was selected to prepare this paper largely  
19 because of my expertise in both planning and rate design.

20 **Q. HAVE YOU TESTIFIED PREVIOUSLY IN RHODE ISLAND?**

1     A.     Yes. My first appearance as an expert witness in Rhode Island was in 1979. Since the  
2           early 1980s, I have testified on behalf of the Rhode Island Division of Public Utilities and  
3           Carriers on numerous occasions.

4

## 2. SUMMARY

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A. The purpose is to provide assistance to the Commission in determining the appropriate form of regulation for Island Hi-Speed Ferry LLC (IHSF). While my focus is on IHSF, I will, when necessary, address the other provider of ferry service to Block Island, Interstate Navigation Company (Interstate).

**Q. WHAT ARE THE KEY POINTS OF YOUR TESTIMONY?**

A. The key points are as follows:

- The scope of economic regulation is broad. It includes the use of price floors.
- Price reductions by IHSF could lead to increases for Interstate's captive customers. Imposition of a price floor would remove this risk.
- Because IHSF service is non-essential, a revenue cap for IHSF would not be appropriate.

**Q. WHAT FORM OF REGULATION DO YOU RECOMMEND?**

A. I recommend that the Commission impose a price floor. IHSF should be permitted to raise, not lower, its current charges.

### 3. DETAILED TESTIMONY

**Q. WHAT IS THE SCOPE AND PURPOSE FOR THIS DOCKET?**

A. This docket is divided into two phases. In the first phase, the Commission will consider the **form of regulation** to be applied to IHSF. A second phase, if needed, will review IHSF's cost of service and the reasonableness of IHSF's current rates.

**Q. PLEASE DISCUSS THE SCOPE FOR SELECTION OF A FORM OF REGULATION.**

A. The scope is quite broad. A well-known textbook on regulation, *Economics of Regulation and Antitrust*, by Viscusi et.al. (3<sup>rd</sup> Edition, MIT Press, 2000) discusses that scope, and, in the process, makes the following points:

- Regulation is generally defined as any state imposed restriction on the discretion exercised by individuals or firms, supported by the threat of sanction.
- Economic regulation is one among many types of regulation. It typically involves restrictions in three areas: price, quantity, and entry and exit. Less frequently restricted areas include product quality and investment.
- Price regulation may specify a particular price or price structure, or may require prices to be within some range. When there is concern that price cutting which might harm competitors, regulation may include the setting of a price floor.

**Q. IS THE SAME FORM OF REGULATION APPLIED TO ALL FERRY SERVICE IN A STATE?**

1 A. No. The situation in Massachusetts shows this quite clearly. The Wood's Hole, Martha's  
2 Vineyard and Nantucket Steamship Authority is considered to provide an essential  
3 function: year-round ferry transport for persons, vehicles, and goods to and from  
4 Nantucket and Martha's Vineyard. Rates are set by the state to ensure sufficient income  
5 to cover the cost of service. Boston Harbor Cruises and Bay State Cruise Company offer  
6 ferry service between Boston and Provincetown. Ferry service between Boston and  
7 Provincetown is not considered essential. Thus, while these companies are subject to  
8 regulation by the U.S. Coast Guard for safety and other issues, their rates are not  
9 regulated by the state of Massachusetts.

10 **Q. HOW IS FERRY SERVICE TO BLOCK ISLAND CURRENTLY REGULATED?**

11 A. Block Island currently has two types of ferry service: high-speed, passenger-only service  
12 during the summer season provided by IHSF and slower, passenger, vehicle, and freight  
13 service year round provided by Interstate. Interstate is currently subject to rate base/rate-  
14 of-return regulation by the Rhode Island Commission. For IHSF, the Commission made  
15 a determination of required revenues. However, it did not set rates for IHSF based on the  
16 required revenues because ridership could not be determined with reasonable accuracy.  
17 Instead, rates were set at the level proposed by IHSF.

18 **Q. WHAT CONSIDERATIONS SHOULD SHAPE THE COMMISSION'S CHOICE**  
19 **OF THE FORM OF REGULATION FOR IHSF?**

20 A. In order to decide what form of regulation to apply, the Commission needs to determine  
21 what issues regulation needs to address and how best to address them. For IHSF service  
22 to Block Island, one issue is the impact price decreases might have on Interstate. IHSF  
23 provides faster service and greater amenities (i.e., reservations, better facilities, etc.) than



1 Interstate. Without a price floor for IHSF service, IHSF might drop its fares, to see if this  
2 produces a gain in ridership sufficient to raise revenues and profits. If IHSF's rates were  
3 to fall, one could expect some of Interstate's seasonal customers to transfer to IHSF. This  
4 could drive up the rates for Interstate's "captive" customers (off-season passengers,  
5 vehicles, and freight).

6 **Q. HOW MIGHT THE COMMISSION PROTECT INTERSTATE'S**  
7 **CAPTIVE CUSTOMERS?**

8 A. Currently, IHSF's charge for passenger service is \$26 per round trip, double the  
9 rate for Interstate. Until there is evidence that Interstate has lost significant  
10 ridership to IHSF, it is reasonable to assume that the current premium (\$13 per  
11 round trip) has been sufficient to protect Interstate's customers. Thus, for now, it  
12 would be reasonable to adopt the current rates as a price floor for IHSF.

13 **Q. SHOULD THE REVENUE CAP CURRENTLY IN PLACE FOR IHSF BE**  
14 **CONTINUED?**

15 A. No. Travelers do not need to rely on IHSF for ferry service to Block Island. In general  
16 government does not regulate the prices for, or revenues from, non-essential services.  
17 IHSF took a significant risk, going into business with its fares fixed in advance. The  
18 rewards our economy provides to successful risk-takers are often quite large initially. In  
19 the long run, one might reasonably expect IHSF to restrain its rates, to avoid attracting  
20 other ferry service providers who might engage in direct price competition with them.

21 Discussion in the Commission's previous order dealing with IHSF's rates  
22 supports the position that no revenue cap is required for IHSF. Section IV-14 of Order

1 15816, captioned “The Rate Setting Process and the Imposition of a Revenue Cap,”  
2 included the following comments:

- 3 • There is no legal requirement that rates be set solely on the basis of the  
4 applicant’s revenue requirements or revenue projections or even on the  
5 basis of cost of service/rate of return; only that the rates set be just and  
6 reasonable.
- 7 • Bell Atlantic-Rhode Island (BA-RI) was, at the time of the IHSF order,  
8 permitted to set the prices or rates for various products and services  
9 deemed discretionary without a requirement that any excess earnings  
10 be returned to the ratepayers.

11 When the Commission issued Order 15816, BA-RI was the **monopoly** provider of the  
12 discretionary products and services over which it had price control. There was no  
13 competitive provider to which consumers could turn for alternatives. In contrast, IHSF  
14 offers an **alternative** to Interstate’s service.

15 **Q. IS YOUR POSITION ON THE REVENUE CAP CONSISTENT WITH THE**  
16 **COMMISSION’S TREATMENT OF OTHER NON-ESSENTIAL FERRY**  
17 **SERVICE?**

18 A. Yes. In its recent orders dealing with the rates for the Jamestown and Newport Ferry and  
19 the New England Fast Ferry LLC, the Commission noted that neither of these ferries  
20 provides “lifeline service.” The Commission approved rates for both of these ferry  
21 services without the imposition of a revenue cap. As these examples make clear,  
22 continuation of a revenue cap for IHSF would not be consistent with the Commission’s  
23 recent treatment of other non-essential ferry services.

1    **Q.     DOES THIS COMPLETE YOUR TESTIMONY?**

2    **A.     Yes, it does.**

**Dr. Stutz's Testimony Before Regulatory Commissions**

<b>STATE</b>	<b>APPEARANCES</b>		<b>STATE</b>	<b>APPEARANCES</b>	
	<u>Rate-making</u>	<u>Planning</u>		<u>Rate-making</u>	<u>Planning</u>
Alabama	1		Minnesota	2	
Arizona	4		Mississippi	1	
Arkansas	1		Nevada	4	3
Canada	8		New Jersey	6	
Colorado	5	4	New York		5
Connecticut	3	3	New Mexico	5	
Delaware	1		New Hampshire	2	
District of Columbia	1		North Carolina	3	
FERC		3	Ohio	5	1
Florida	1	3	Oregon	1	
Georgia		1	Pennsylvania	2	4
Hawaii		1	Rhode Island	17	3
Illinois	1	3	South Carolina	1	
Iowa	1		Tennessee	1	
Kansas	1		Texas	7	1
Kentucky	1		Utah	2	
Louisiana	2		Vermont	3	1
Maine	11	5	Virginia	1	
Maryland	2		Washington		1
Massachusetts	1	4	West Virginia	3	
Michigan	2	12	Wisconsin	1	
				<u>Total</u>	<u>Total</u>
				<u>Rate-making</u>	<u>Planning</u>
				114	58

(from resume of J. Stutz as of 5 /03)

